

For Appellant: Philip D. Bartz,
Attorney at Law

For Respondent: Richard Gould,
Counsel

^{1/} Unless otherwise specified, all section references hereafter in the body of this opinion are to sections of the Revenue and Taxation Code as in effect for the years in issue.

Appellant is a Maryland resident and, for the appeal years, filed California nonresident personal income tax returns (forms 540NR) with respect to his California-source partnership income. During the years in issue, appellant was a partner in a law firm, Morrison & Foerster, which did business in California and Maryland, as well as other states. Appellant reported his California-source income on his Maryland personal income tax return and paid Maryland taxes thereon. The Maryland tax consists of two elements - a 5 percent state income tax and a surcharge equal to between 20 and 50 percent of the state income tax, depending on the location of the taxpayer's residence. (See Md. Code Ann., Tax Gen. §§ 10-102, 10-103, 10-105, 10-106; [2 Md.] St. Tax Rptr. (CCH) ¶¶ 94-777, 94-778, 94-780, 94-782.)^{2/} Appellant claimed the Maryland state income tax and surcharge as a credit for taxes paid to other states on his California forms 540NR.

Respondent denied appellant's claim for credit with respect to the surcharge, asserting the surcharge is a local income tax and no credit is available for taxes paid to political subdivisions of the state, such as cities or counties. Consequently, notices of proposed assessment (NPAs) were issued imposing additional taxes and interest. After protest, respondent affirmed its NPAs, and this appeal followed.

Every nonresident is subject to California personal income tax on his entire taxable income derived from sources within this state. (Rev. & Tax. Code, § 17041, subd. (b).) However, under certain conditions, nonresidents are allowed a credit against their California personal income tax for net income taxes "imposed by and paid to" their state of residence on income also taxable in this state. (See Rev. & Tax. Code, § 18002, subd. (a) and (b); Appeal of Harold E., Jr., and Rosemary G. Donnell, 87-SBE-065, Oct. 6, 1987.) The sole issue to be decided in this appeal is whether appellant is entitled to claim such a credit for payment of the Maryland surcharge.

Appellant assumes there is no dispute that the Maryland surcharge is "paid" to the state

^{2/} Provision was first made for the imposition of a local income tax by the several counties and the City of Baltimore, to be collected by the Comptroller of the Treasury, by Chapter 142, § 6 of the Laws of 1967. As amended, the provision [appeared] in section 283. Code (1957, 1969 Repl. Vol., 1973 Cum. Supp.) Art. 81, § 283 (a) provides in part:

"The county council or board of county commissioners of any county and the mayor and city council of Baltimore, by ordinance or resolution enacted pursuant to their ordinary and regular legislative procedure, shall adopt, by reference, a local income tax imposed upon the residents of any county or Baltimore City as a percentage of the liability of such resident for State income tax. Any ordinance or resolution so enacted shall impose a rate of tax for any current calendar year and may provide that such tax rate shall continue in effect for each succeeding calendar year, unless and until such tax rate is changed or modified by a subsequent ordinance or resolution. Any income tax so adopted shall not be less than twenty (20) percent nor more than fifty (50) percent of the State income tax liability of such resident, and any such tax imposed, and any increase or decrease in any tax so imposed, shall be in increments of five (5) percent."

Stern v. Comptroller of the Treasury, 271 Md. 310, 311-312 [316 A.2d 240] (1974).

because it is collected either through withholdings from appellant or through payments made in connection with the filing of the annual Maryland tax return. Instead, appellant argues the dispute is centered on whether the surcharge is imposed by the state. He believes it is so imposed because article 14 of the Maryland constitution does not authorize counties to impose any tax, and the surcharge is imposed by the Maryland legislature and is administered by the Maryland Comptroller's office. Appellant avers the counties of Maryland have no discretion as to whether to impose the surcharge (see Stern v. Comptroller of the Treasury, 271 Md. 310 [316 A.2d 240] (1974)) and submits a letter from the director of the Income Tax Division of the Maryland Comptroller of the Treasury ("Comptroller") stating the surcharge is imposed by the State of Maryland. Appellant also asserts the respondent is attempting to rewrite section 18002 by disallowing the credit for taxes imposed by the state but "used by" a local government.^{3/} In spite of the Comptroller's letter, we believe appellant is wrong in all respects.

Deductions and credits are a matter of legislative grace and are allowable only where the conditions established by the legislature have been satisfied. (See New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of Frederick A. Sebring, Cal. St. Bd. of Equal., Dec. 9, 1980.) Statutory provisions for tax credits must be narrowly and strictly construed against the taxpayer. (William Lyon Company v. Franchise Tax Board, 4 Cal.App.4th 267 [5 Cal.Rptr.2d 680] (1992); Miller v. McColgan, 17 Cal.2d 432, 442 [110 P.2d 419] (1941).) In this instance, appellant has failed to establish the Maryland surcharge is either "imposed by" or "paid to" the state. The legislative history of the surcharge and the language of the statute itself clearly indicate the surcharge is imposed by the counties of Maryland and the City of Baltimore. The statute passed by the Maryland General Assembly is enabling legislation. If the surcharge was imposed by the state, then there would be no need for the enabling legislation to mandate the adoption of local ordinances and resolutions to authorize the tax. (See Stern v. Comptroller of the Treasury, supra, Coerper v. Comptroller of the Treasury, 265 Md. 3 [288 A.2d 187] (1972), and Commonwealth v. Smith, 232 Va. 407 [350 S.E.2d 645] (1986), for a discussion of the relevant Maryland statutory scheme.) Any other interpretation would render the local ordinances and resolutions a nullity. In fact, as originally enacted, Baltimore and the

^{3/} Appellant's supplemental charge that respondent's actions are motivated by its desire to protect the public fisc is usually reserved for those taxpayers who have no legal basis for their claims and are, thus, truly desperate. In this instance, it is indicative of the viability of appellant's position.

counties of Maryland had discretionary authority to adopt local laws imposing the surcharge. (See Commonwealth v. Smith, supra.)^{4/}

Moreover, our analysis of the Maryland surcharge leads us to the conclusion that such a tax is not "paid to the state." A "state" includes any of the fifty states, the District of Columbia, and any U.S. possession. (See Rev. & Tax Code, § 17018, and Cal. Code Regs., tit. 18, reg. 18001-1, subd. (a).) The Maryland courts have consistently stated that while the Comptroller collects the surcharge, the funds are returned to, or "paid to," the county where the taxpayer resides. (See Stern, supra, and Coerper, supra.) Thus, with respect to its surcharge, the State of Maryland is merely acting as a collection agent for its various counties and the City of Baltimore. There are many instances where the state acts in such a capacity, and respondent cites the perfect example of New York State where its Department of Taxation and Finance performs all the administrative and collection functions in connection with the New York City personal income tax. Appellant argues the fact that a state distributes the funds it collects from taxpayers back to its political subdivisions does not per se render it a local tax, but is basically a normal governmental activity. However, with respect to the Maryland surcharge, the state is not simply allocating general funds to its localities, but is earmarking the monies collected and specifically returning them to the taxpayer's county of residence (or the City of Baltimore, as the case may be). Therefore, the surcharge is in effect being "paid to" the political subdivisions of Maryland, and not to the state.

Furthermore, the Maryland courts and legislature have consistently treated the surcharge differently from the state income tax. For example, in Coerper, the taxpayer, a Maryland resident with New York-source income, attempted to calculate the amount of the surcharge after deducting his New York tax liability from his state income tax. The court ruled that the surcharge had to be based on the full state income tax liability, prior to deducting income taxes paid to other states. Stern, a case which appellant relies heavily upon, involves a Maryland resident who was a partner at a New York law firm. There, the taxpayer was allowed to eliminate both his state income tax and surcharge liability by taking a credit for income taxes paid to New York. Looking at the statutory language of Maryland's credit provisions, the court found the credit for taxes paid to other states was applicable against both the state income tax and the surcharge because they were part of the same subtitle. Shortly thereafter, the Maryland legislature reversed the result of Stern by expressly disallowing the use of the credit for taxes paid to other states against the surcharge. (See Commonwealth v. Smith, supra.)

It is interesting to note that in both Coerper and Stern, the Maryland Court of Appeals

^{4/} As section 283(a) originally appeared in Chapter 142, § 6 of the Laws of 1967, it provided that the counties and Baltimore City "may adopt" local income taxes. However, section 323, also enacted by Chapter 142, § 6, required each county and Baltimore City to impose an income tax for the calendar year 1967. The discretionary language in section 283(a) became obligatory by Chapter 422 of the Laws of 1969, effective 1 July 1969, when "may adopt" was amended to read "shall adopt."

Stern, supra, at 314.

consistently referred to the surcharge as a local income tax. More importantly, contrary to the position taken by the Comptroller in this appeal, the Comptroller in Stern argued the surcharge was imposed by the counties of Maryland. The court found this argument attractive, but had to rule in favor of the taxpayer because of the structure of the Maryland taxing statutes.

Commonwealth v. Smith contains facts remarkably similar to this appeal. The taxpayers were Maryland residents with Virginia-source income who attempted to take as a credit against their Virginia income tax liability the Maryland state income tax and surcharge. Virginia law provides a credit to nonresidents who "become liable for income tax to the state" of residence. In disallowing the credit for the surcharge, the Virginia Supreme Court rejected the trial court's ruling that the surcharge was paid to the State of Maryland, and referred to the surcharge as a local income tax. Appellant contends Commonwealth v. Smith has little significance because it deals with a Virginia statute which is worded differently. We disagree. The case involves the interpretation of the same Maryland surcharge with which we are concerned. In addition, the language of the Virginia credit appears to be broader than the language of the California credit - if a taxpayer cannot be deemed to be liable to the State of Maryland for the surcharge, how can that same taxpayer be deemed to have paid the surcharge to the State of Maryland?

In conclusion, we find the Maryland surcharge is a local income tax which is neither imposed by nor paid to the State of Maryland. Accordingly, respondent's action in this matter will be sustained.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19047 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Philip D. Bartz against proposed assessments of additional personal income tax in the amounts of \$1,323.87 and \$998.55 for the years 1989 and 1990, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of September, 1994, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Fong, Mr. Dronenburg, and Ms. Scott present.

Brad J. Sherman, Chairman

Matthew K. Fong, Member

Ernest J. Dronenburg, Jr., Member

Windie Scott*, Member

_____, Member

*For Gray Davis, per Government Code section 7.9.

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